

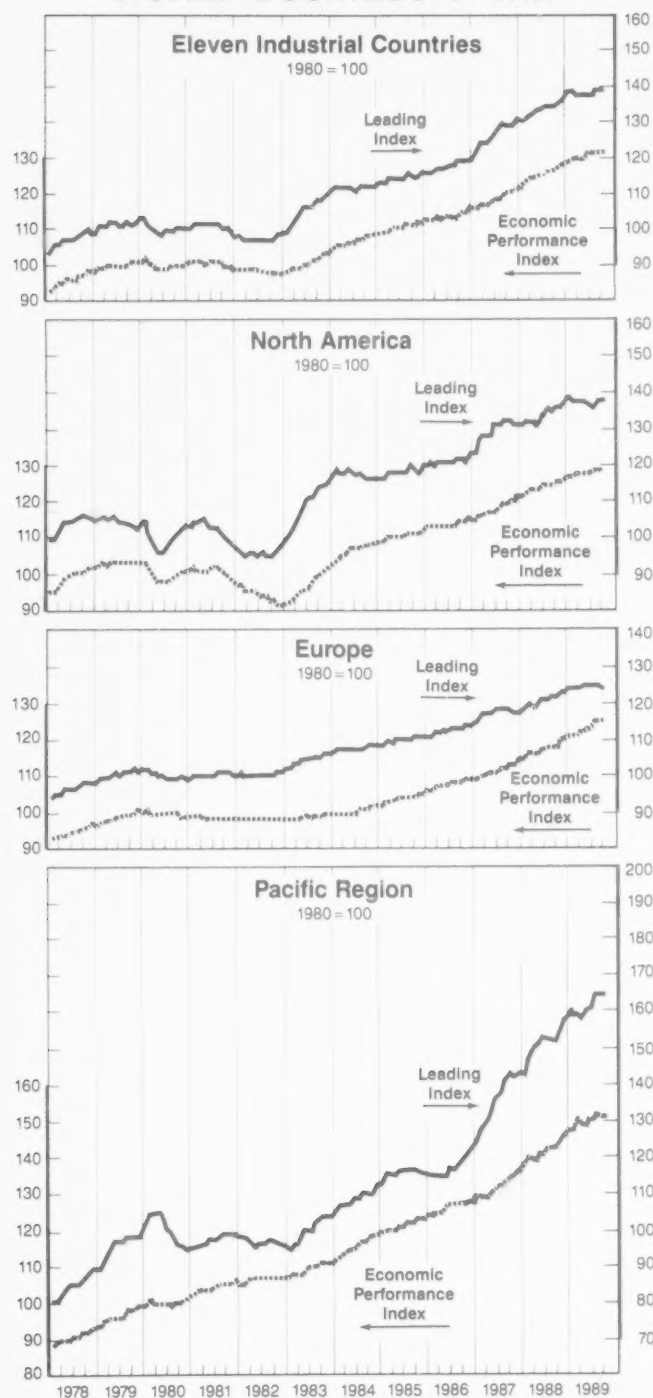


International Economic Scoreboard

A Quarterly Report from The Conference Board

First Quarter 1990

WORLD BUSINESS CYCLE



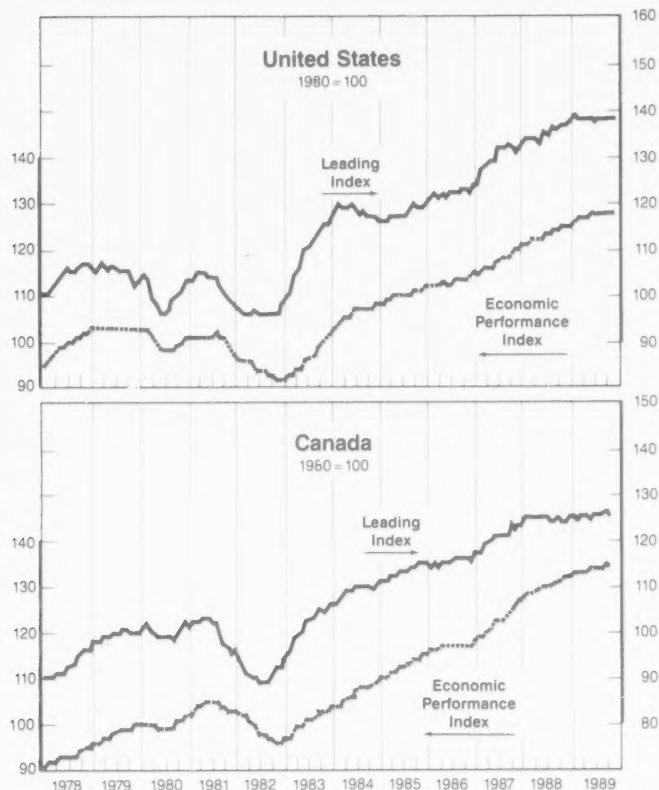
The pronounced leveling-off in the 11-country leading index that first showed up early in 1989 continued into the fourth quarter. The economic performance index continues to advance slowly, and the leading index suggests nothing better than that is likely during at least the early months of 1990.

The regional pattern that prevailed most of the time in recent years (but not for the past few months) reappears in the latest data. The Pacific Region—primarily Japan—again shows a more encouraging picture than Europe and North America.

But the data have changed in one important way: There is suddenly much less conformity of pattern from country to country. Although the leading indexes have been through periods of slow growth now and again (1985, 1989), it's been a long time since we've had a report that showed more than one country with a negative growth rate in its leading index. This month the *Scoreboard* shows four countries with leading indexes that have turned down, albeit modestly. That hasn't happened since 1982.

The two countries at opposite ends of the scale are Australia and Japan. The Australian data, while not decisively dismal, are giving off more than a whiff of recession. The Japanese data, by contrast, once again look quite propitious.

NORTH AMERICAN COUNTRIES



The U.S. leading index continues on an even keel but is going nowhere. November was unchanged for the third consecutive month. December will again be flat to down, early data suggest. If there's any business-cycle move in the offing—either a take-off or a turndown—it has yet to show up in our early warning indexes.

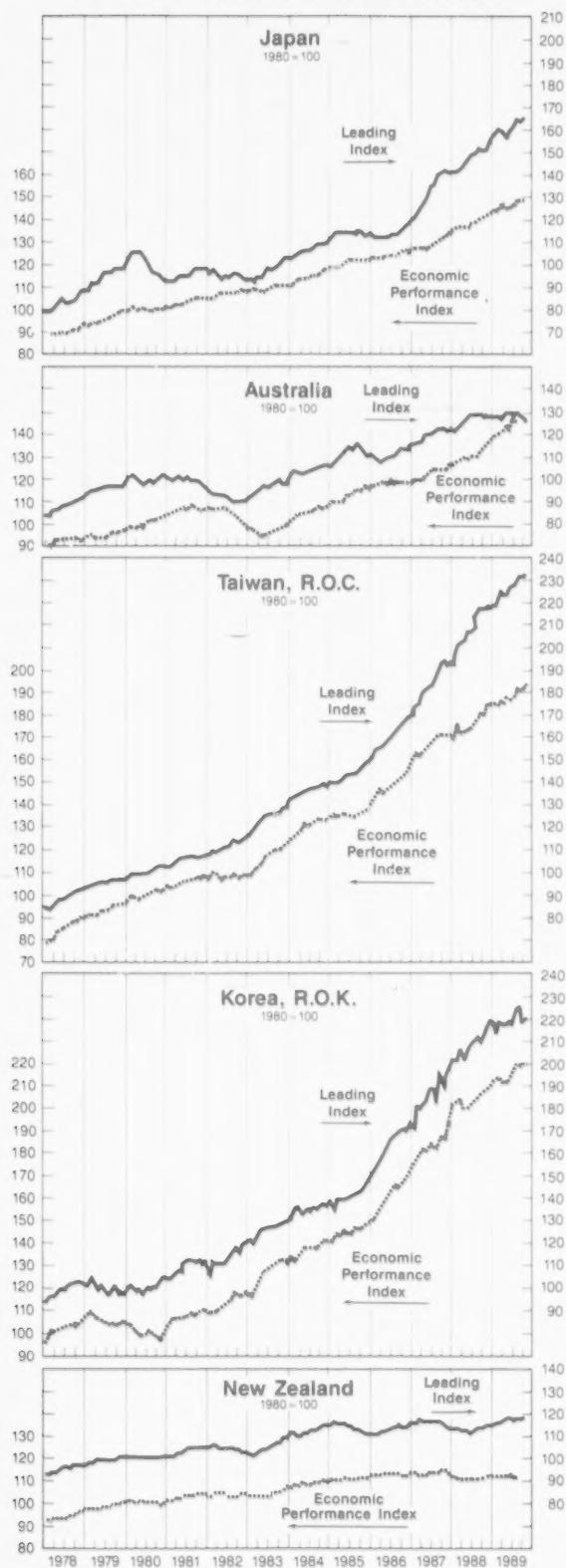
The figures for Canada show almost the same pattern as the United States, except that the Canadian leading index first leveled off a year earlier than in the U.S., in early '88. Prospects are mushy.

Summary Of Growth Rates, Eleven Industrial Countries

	Ten-year Growth Rate	Indexes of Economic Performance Growth Rates*			Leading Business Cycle Indexes Growth Rates*			Current Reading on the Cycle	Latest Month Covered
	6 mos. ago	3 mos. ago	Latest month	6 mos. ago	3 mos. ago	Latest month			
	annual rates, percent								
Eleven countries	3	5	4	3	4	2	2	Expansion continuing	Oct.
Ten countries excl. U.S.	3	5	5	4	5	4	3	Expansion continuing	Oct.
North America (2)	3	4	3	1	2	-2	1	Expansion continuing, leaders weak	Oct.
Europe (4)	2	5	5	5	4	2	0	Expansion continuing, leaders weak	Oct.
Pacific Region (5)	4	5	6	4	7	6	7	Expansion continuing	Oct.
United States	3	4	3	1	2	1	1	Expansion continuing, leaders weak	Nov.
Canada	3	3	2	1	0	1	1	Expansion continuing, leaders weak	Oct.
West Germany	2	4	5	3	7	5	3	Expansion continuing	Nov./Oct.
France	2	8	7	5	5	1	-1	Expansion continuing, leaders weak	Oct./Nov.
United Kingdom	2	5	5	5	1	0	-1	Expansion continuing, leaders weak	Oct.
Italy	2	-1	2	6	-1	1	-2	Expansion resuming, leaders weak	Oct.
Japan	4	5	5	4	7	7	9	Expansion continuing	Oct.
Australia	3	13	11	6	3	1	-4	Expansion continuing, leaders weak	Oct./Nov.
Taiwan, R.O.C.	8	7	6	6	6	9	7	Expansion continuing	Nov.
Korea, R.O.K.	7	3	9	6	4	8	1	Expansion continuing, leaders weak	Nov.
New Zealand	2	2	2	0	5	2	5	Upturn developing	Aug./Oct.

* Ratio of current month's index to average index over the preceding 12 months, expressed as a compound annual rate.

PACIFIC REGION COUNTRIES



The Japanese outlook has reversed itself once again. This time the reason is more favorable data for inventories and corporate profits. We believe these wild gyrations in the outlook are almost entirely the result of volatile data, in part related to the introduction of the value added tax earlier this year. Our best guess is that the business cycle outlook is favorable in Japan, but less so than the great strength in the leading index since the spring would suggest.

The Australian leading index has declined further. Among the component series that make up the leading index, the most important was the money supply, which has been falling steadily and sharply since last February. Recession is a distinct possibility.

The story in Taiwan is a simple "steady as she goes." The performance index is growing at a 6 percent rate and the leading index at 7 percent, both fairly close to the 10-year average for the Taiwanese economy. We look for more of the same.

Interpreting the Korean indexes is a formidable task these days. The data have been jumping around more than usual. Over the past year the performance index has continued to advance at about the trend rate, but the leading index has barely done better than hold its own.

The New Zealand indexes are also mixed. The performance index bottomed out in 1988 but nevertheless showed little growth in 1989, despite a signal from the leading index that a moderate cyclical recovery should have begun. That's still the best bet.

WHAT'S AHEAD FOR INFLATION?

Except for unemployment, no measure of economic activity commands as much attention as inflation. Although the cyclical indexes featured in this publication usually focus on the real dimensions of the economy, they are also useful to show whether inflationary pressures are intensifying or subsiding.

Over the long haul, inflation is primarily a monetary phenomenon—"too much money chasing too few goods," as the classic definition puts it. In the short run, however, the most important factors determining whether inflation is accelerating or slowing are the economy's operating rate and the direction of the business cycle. When the business cycle is high and rising the inflation rate will accelerate; when the cycle is headed down, inflation will subside. Consequently, the *Scoreboard's* indexes can be used to generate an early warning of where inflation is headed, just as they are always used to forecast the direction of the business cycle.

Some years ago the Center for International Business Cycle Research (CIBCR) developed a forecasting system designed to send out a warning signal when the economy

is headed for either a slowdown or a recovery. The initial signal of a slowdown appears when the growth rate of the leading index falls significantly below the long-term growth rate, and a confirming (or final) signal is sounded when the growth rate of the economic performance index also falls significantly below the long-term rate. Correspondingly, signals of recovery are recorded when the growth rates of the leading and performance indexes rise significantly above their long-term rates.

A key question in designing this forecasting system is where to set the trigger point. In other words, how far below the long term average does the current growth rate have to fall before the signal is activated? That is always a difficult question, because it involves a trade-off between timeliness and reliability. If a wide margin is established, the risk of getting a false signal is reduced, but it increases the risk that the signal will appear too late to be useful. Alternatively, if a narrow margin is established in order to get an early forecast of the slowdown, then the reliability of that signal becomes doubtful.

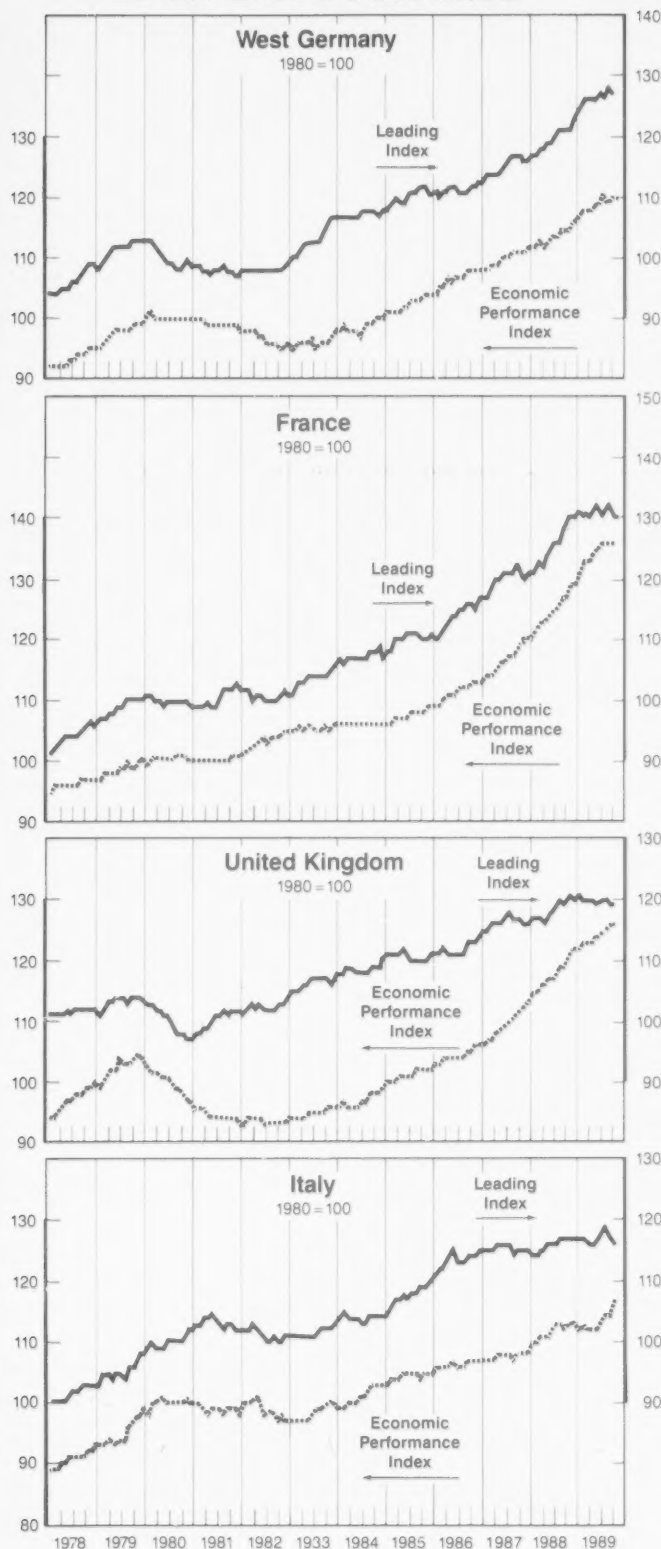
For its signaling system, CIBCR reached a simple com-

LATEST SIGNALS ON GROWTH AND INFLATION

	Trend rate, 1976-86 (%)	Signals of slowdown		Signals of upturn		Indicated condition of inflation
		Initial	Confirmed	Initial	Confirmed	
United States	3	3/89	9/89	—	—	Slowdown
Canada	3	7/88	7/89	—	—	Slowdown
West Germany	2	—	—	12/86	12/86	Upswing
France	2	7/89	—	—	—	Slowdown
United Kingdom	2	3/89	—	—	—	Slowdown
Italy	2	3/89	3/89	—	—	Slowdown
Japan	4	—	—	10/86	7/87	Upswing
Australia	3	2/89	—	—	—	Slowdown
Taiwan	8	4/89	4/89	—	—	Slowdown
South Korea	7	10/89	11/89	—	—	Slowdown
New Zealand	2	—	—	11/88	—	Upswing
10 Countries excl. U.S.	3	—	—	9/86	9/86	Upswing
11 Countries	3	5/89	—	—	—	Slowdown

Signals are based on the six-month smoothed growth rates (rounded) in the leading and performance indexes. The initial signal of slowdown is the first month that the leading-index growth rate falls below the trend rate by one percentage point or more. The confirming signal of slowdown is the first month that both the leading- and performance-index growth rates fall below the trend rate by one percentage point or more. Analogous definitions apply to the initial and confirming signals of an upswing.

EUROPEAN COUNTRIES



The upward trend of the West German leading indexes has slowed in recent months, but the 3 percent growth rate is better than any of the other major countries of Europe and North America. Outlook: slow growth.

In France, the performance index has flattened following a vigorous advance earlier. The leading index, however, has declined a couple of points, most of which can be traced to weakness in raw-materials prices and order backlogs. We don't expect the economy to do much of anything.

Economic activity in the U.K., as seen in its performance index, continues to work gradually higher. This has been happening despite the fact that the leading index has been flat for some 18 months and is actually down a touch over the course of 1989. Here, too, not much action is likely.

The Italian data are as difficult to read as ever. The performance index has been rising smartly and steadily since midyear. This was true also of the leading index until September, when big drops in working hours and order backlogs reversed the trend. As a result, the October leading index was below its level a year ago, which does not bode well for growth in the economy.

promise on this question: a margin of one percentage point. Thus when the growth rate of the leading index (as an initial signal) and of the performance index (as a confirming or final signal) rises one percentage point above the ten-year trend, this is taken as a signal that the inflation rate will increase. Similarly, when the growth rates of the leading and performance indexes fall one percentage point below the trend rate, which points to a growth slowdown, this is a signal that the inflation rate is going to subside. As with any indicator system, the leads of the initial signal are longer than those of the confirming signal, but also less certain.

The accompanying table shows when the most recent initial and final signals were recorded for each of 11 countries. For the United States the initial signal of a forthcoming decline in the inflation rate appeared in March 1989; this signal was confirmed by the performance index in September. In Canada, both signals pointed to an easing of inflationary pressures as of last July. The overall

record shows that five of the eleven countries have recorded both initial and confirming signals of a slowdown. Three other countries have registered initial signals, which have not been confirmed. And the other three (Japan, Germany and New Zealand) had earlier recorded signals of an upturn in the rate of inflation and no other signal has emerged since then. These three countries, in other words, still appear to be on the track headed toward higher inflation.

If one looks at all the countries together (the 11-country composite index), the message is that an early signal of a slowdown in economic growth has been recorded. In the past this has led to a corresponding easing of inflationary pressures (as the chart illustrates). Whether this forecasting signal will be corroborated or whether the trend it points to is reversed quickly, only time can tell. At the moment, the general pattern suggests that inflation is subsiding among the industrial countries, but that pattern is clearly not a unanimous condition around the world.

Inflation Upswings and Slowdowns



Signals of change in direction of inflation are based on the growth rates of leading and performance indexes for 11 major industrial countries (see text). 1989 signal is based on initial signal only.

The Conference Board

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